

PERFORMANCE AUDIT
OF THE
UNEMPLOYMENT AGENCY

DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

September 2001

EXECUTIVE DIGEST

UNEMPLOYMENT AGENCY

INTRODUCTION	This report, issued in September 2001, contains the results of our performance audit* of the Unemployment Agency (UA), Department of Consumer and Industry Services.
AUDIT PURPOSE	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.
BACKGROUND	<p>UA was created as the Michigan Employment Security Commission (MESC). MESC was created by the Michigan Employment Security Act of 1936 (Sections 421.1 - 421.75 of the <i>Michigan Compiled Laws</i>). Executive Order Nos. 1994-2, 1995-8, 1997-12, and 1997-18 resulted in the creation of UA within the Department of Consumer and Industry Services. Also, the job training functions formerly administered with the Unemployment Insurance Program were transferred to the Michigan Jobs Commission. The primary activity of UA is the payment of unemployment benefits and the collection of unemployment taxes.</p> <p>For fiscal year 1999-2000, UA expended approximately \$906 million from the Unemployment Compensation Fund and \$109 million from the Administration Fund. As of February 28, 2001, UA had 1,189 employees.</p>

* See glossary at end of report for definition.

**AUDIT OBJECTIVES
AND CONCLUSIONS**

Audit Objective: To assess the effectiveness of UA in the payment of unemployment benefits in compliance with applicable laws and regulations.

Conclusion: We concluded that UA was generally effective in the payment of unemployment benefits. However, we noted a reportable condition* related to accounts receivable (Finding 1).

Audit Objective: To assess the effectiveness and efficiency of UA in collecting unemployment taxes in compliance with applicable laws and regulations.

Conclusion: We concluded that UA was generally effective and efficient in collecting unemployment taxes in compliance with applicable laws and regulations. However, we noted reportable conditions related to information from the Department of Treasury, collection of delinquent unemployment taxes, and automated information systems (Findings 2 through 4).

Audit Objective: To assess the adequacy of UA's monitoring of its progress towards achieving complete customer satisfaction.

Conclusion: We concluded that UA had adequate monitoring of customer satisfaction. UA established three-year strategic goals* including a goal of improving customer satisfaction to 94.0% by December 31, 2001. Surveys in 2000 and 1998 of customer satisfaction of employers that pay unemployment taxes and of jobless

* See glossary at end of report for definition.

workers collecting unemployment benefits had the following results:

	<u>Customer Satisfaction</u>	
	<u>2000</u>	<u>1998</u>
Employers paying unemployment taxes	71.7%	86.8%
Jobless workers collecting unemployment benefits	90.0%	91.0%

AUDIT SCOPE AND METHODOLOGY

Our audit scope was to examine the program and other records of the Unemployment Agency. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our methodology included examining UA's records for the period October 1, 1998 through February 28, 2001. Our methodology also included a preliminary review, which consisted of interviewing various personnel and reviewing reports and procedures to gain an understanding of and to form a basis for selecting UA operations to audit. We also reviewed the goals and objectives* of UA as they related to its mission*.

We reviewed a sample of unemployment benefit payments for documentation of compliance with applicable requirements. We also reviewed a sample of tax reports, recalculated the taxes and tax rates, and reviewed the collection of delinquent accounts. In addition, we reviewed UA surveys of customers to assess customer satisfaction and changes made to improve customer satisfaction.

* See glossary at end of report for definition.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report contains 4 findings and 5 corresponding recommendations. UA's preliminary response indicated that it agrees with all of our findings.

UA complied with the 10 prior audit recommendations included within the scope of our current audit.

September 25, 2001

Mr. Jack F. Wheatley, Director
Unemployment Agency
Landmark Building
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Wheatley and Ms. Wilbur:

This is our report on the performance audit of the Unemployment Agency, Department of Consumer and Industry Services.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Unemployment Agency (UA), Department of Consumer and Industry Services, was created as the Michigan Employment Security Commission (MESC). MESC was created by the Michigan Employment Security Act of 1936 (Sections 421.1 - 421.75 of the *Michigan Compiled Laws*). Executive Order Nos. 1994-2, 1995-8, 1997-12, and 1997-18 resulted in the creation of UA within the Department of Consumer and Industry Services. Also, the job training functions formerly administered with the Unemployment Insurance Program were transferred to the Michigan Jobs Commission. The primary activity of UA is the payment of unemployment benefits and the collection of unemployment taxes.

The primary responsibility of the Unemployment Insurance Program is to collect unemployment taxes from employers and to pay unemployment benefits to eligible unemployed persons (claimants*). UA administers the collection of tax payments from its central office in Detroit and has a Statewide network of 41 branch offices, organized into 4 regions, to process claims for unemployment benefits. After eligibility criteria have been satisfied, the UA central office processes and mails the unemployment checks to the claimants.

For fiscal year 1999-2000, UA expended approximately \$906 million from the Unemployment Compensation Fund and \$109 million from the Administration Fund. As of February 28, 2001, UA had 1,189 employees.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit of the Unemployment Agency (UA), Department of Consumer and Industry Services, had the following objectives:

1. To assess the effectiveness of UA in the payment of unemployment benefits in compliance with applicable laws and regulations.
2. To assess the effectiveness and efficiency of UA in collecting unemployment taxes in compliance with applicable laws and regulations.
3. To assess the adequacy of UA's monitoring of its progress towards achieving complete customer satisfaction.

Audit Scope

Our audit scope was to examine the program and other records of the Unemployment Agency. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, performed between October 2000 and February 2001, included examining UA's records for the period October 1, 1998 through February 28, 2001. Our methodology also included a preliminary review, which consisted of interviewing various personnel and reviewing reports and procedures to gain an understanding of and to form a basis for selecting UA operations to audit. We also reviewed the goals and objectives of UA as they related to its mission.

To accomplish our first objective, we obtained an understanding of the process of applying for unemployment benefits, determining eligibility, adjudicating separation issues, and determining restitution. In addition, we reviewed a sample of unemployment benefit payments for documentation of compliance with applicable requirements.

To accomplish our second objective, we obtained an understanding of the process for calculating employer tax rates and collecting unemployment taxes including delinquent taxes and the related reports. In addition, we reviewed a sample of tax reports and recalculated the taxes and tax rates. We also reviewed the collection of delinquent accounts.

To accomplish our third objective, we reviewed UA surveys of customers to assess customer satisfaction and changes made to improve customer satisfaction.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 4 findings and 5 corresponding recommendations. UA's preliminary response indicated that it agrees with all of our findings.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Consumer and Industry Services to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

UA complied with the 10 prior audit recommendations included within the scope of our current audit.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

PAYMENT OF UNEMPLOYMENT BENEFITS

COMMENT

Audit Objective: To assess the effectiveness of the Unemployment Agency (UA) in the payment of unemployment benefits in compliance with applicable laws and regulations.

Conclusion: We concluded that UA was generally effective in the payment of unemployment benefits. However, we noted a reportable condition related to accounts receivable.

FINDING

1. Accounts Receivable

UA did not reconcile the accounts receivable recorded for benefit overpayments and amounts due from reimbursable employers in the Unemployment Compensation Fund to the related subsidiary detail. As a result, as of September 30, 2000, the total accounts receivable of \$158.1 million recorded by UA exceeded the amount recorded in the subsidiary detail by approximately \$18.8 million.

Reconciliations should be regularly performed so that errors can be corrected or amounts omitted from the subsidiary detail can be identified and properly recorded.

We were informed that reconciliations have not been performed for several years. Because the subsidiary detail is used to collect accounts receivable, UA may not collect benefit overpayments or amounts due from reimbursable employers that were omitted from the subsidiary detail.

RECOMMENDATION

We recommend that UA regularly reconcile the accounts receivable recorded for benefit overpayments and amounts due from reimbursable employers in the

Unemployment Compensation Fund to the related subsidiary detail and correct any differences.

AGENCY PRELIMINARY RESPONSE

UA agrees with the finding and informed us that it is currently in the process of redesigning its computerized system and consolidating all of the subsystems onto a single platform. In order to bring up the single platform, a comprehensive analysis will be performed between the general ledger balances and the balances of the collection unit. Correcting adjustments will be made to arrive at a single balance. The single platform will eliminate the possibility of inconsistent information in the future.

COLLECTION OF UNEMPLOYMENT TAXES

COMMENT

Audit Objective: To assess the effectiveness and efficiency of UA in collecting unemployment taxes in compliance with applicable laws and regulations.

Conclusion: We concluded that UA was generally effective and efficient in collecting unemployment taxes in compliance with applicable laws and regulations. However, we noted reportable conditions related to information from the Department of Treasury, collection of delinquent unemployment taxes, and automated information systems.

FINDING

2. Information From the Department of Treasury

UA could increase its effectiveness in collecting delinquent unemployment taxes by obtaining additional information from the Department of Treasury.

The Department of Treasury is able to provide tax information to UA in accordance with Section 205.28 of the *Michigan Compiled Laws* and under the terms of an Internal Revenue Service agreement. UA obtains information from the Department of Treasury based on individual requests from its tax collectors. However, UA does not obtain information that may be necessary to collect delinquent unemployment taxes, such as a listing of all employers submitting payroll withholding taxes or all employers changing addresses.

Our review of 52 employers with delinquent unemployment taxes as of December 31, 1999 disclosed that 7 of these employers with balances of \$105,000 had been inactivated for collection activities in UA records for not filing quarterly tax reports as provided by federal regulations. However, UA inactivated these employers without receiving notices from the employers that they were discontinuing business or were bankrupt. Two of these employers subsequently had employees file for unemployment benefits for periods UA had inactivated the employer. A comparison of employers inactivated by UA with a listing of employers that submit payroll withholding taxes to the Department of Treasury could disclose employers that should still be actively paying unemployment taxes.

Other information on employers available from the Department of Treasury, such as change in address, filing for bankruptcy, discontinuance of business, starting a business, and sale of a business, would be helpful to UA in locating businesses because sometimes businesses do not give this information to UA. We were informed that tax collectors usually did not attempt to access Department of Treasury information partly because the access terminals were not convenient.

RECOMMENDATION

We recommend that UA increase its effectiveness in collecting delinquent unemployment taxes by obtaining additional information from the Department of Treasury.

AGENCY PRELIMINARY RESPONSE

UA agrees with the finding and informed us that it is currently participating in a series of meetings with Department of Treasury executives for the purpose of improving operational efficiencies for both departments. At these meetings, UA will request additional authorization to access Department of Treasury system databases. One example of the need for additional access is UA's Tax Office for which access is currently authorized at the management level, but not for individual tax collectors.

UA is currently redesigning all of its systems. Accordingly, efforts will be made to incorporate an automated means of obtaining employer related information from the Department of Treasury.

FINDING

3. Collection of Delinquent Unemployment Taxes

UA could improve collection of delinquent unemployment taxes by requiring its tax collectors to better document their contacts with employers.

As of December 31, 2000, there were approximately 45,000 employers that owed approximately \$74.5 million in delinquent unemployment taxes. We reviewed UA collection efforts for 53 of these employers and noted that for 4 employers, owing approximately \$16,000 in delinquent unemployment taxes, UA had little or no documentation of contact with the employers. Proper documentation is necessary to assess and monitor the status of collection efforts because each tax collector is responsible for collecting a large number of delinquent accounts (approximately 2,800 accounts).

Documentation of work done by the collectors on an account is an important element in the collection process. Information, such as a history of contacts made, explanations for delays in payment, and promises of payment, is needed for future collection efforts. This historical information is also needed if the account is reassigned to another collector or is reviewed by a supervisor.

RECOMMENDATION

We recommend that UA improve collection of delinquent unemployment taxes by requiring its tax collectors to better document their contacts with employers.

AGENCY PRELIMINARY RESPONSE

UA agrees with the finding and informed us that it will reemphasize the need for adequately documenting collection efforts at future staff meetings. UA noted that it often handles smaller reoccurring delinquencies by issuing automated written notices and/or automated tax liens, as was the case with the four employers cited for lack of documentation.

FINDING

4. Automated Information Systems

UA should increase the effectiveness and efficiency of its program operations by automating processes and updating existing automated information systems.

UA utilizes automated information systems in most of its program operations, including: accounting, fraud investigation, quality assurance, and program and policy administration.

Our review disclosed that UA has program operations that can still be automated and also that some of UA's existing automated processes need to be improved:

- a. UA needs to automate its process for estimating taxes due from employers who are delinquent in filing quarterly tax reports and payments. This would increase the effectiveness of UA's unemployment tax collection efforts.

For employers that are more than one year behind in filing quarterly tax payments, UA staff would sometimes manually compile estimates of taxes due based on the tax reports filed for prior quarters. UA then used this information to bill the delinquent employers for unpaid taxes and related penalties. Compiling these estimates manually was extremely time consuming because estimates were often needed for several quarters for which tax payments were not made. Also, we noted that UA staff were not always able to manually prepare estimates of taxes due.

We reviewed UA's collection efforts of 50 employers with delinquent unemployment taxes, and noted that 19 of these employers were more than one year behind in the payment of unemployment taxes. Manual estimates of taxes due were not prepared for 14 (73.7%) of these employers. These 14 employers had unpaid balances totaling \$206,000 as of December 31, 2000. This amount is based only on quarterly tax reports filed or estimated and does not include amounts due for those quarters for which tax reports were not filed or estimated.

These estimates were prepared based on historical information available in UA's computer records. Therefore, the estimates could be prepared using an automated information system. UA's Tax Office has recognized the value of automating this process and in 1996 requested its Data Processing Unit to automate this process. However, UA has not allocated resources to make this change.

- b. UA needs to update several of its existing automated information systems in order to improve the effectiveness and efficiency of its accounting and other program operations.

For example, UA utilizes automated information systems to account for benefit overpayments to employees and for amounts due from reimbursable employers. However, UA's systems were not capable of reconciling the total amounts due as recorded in the Unemployment Compensation Fund to the related subsidiary detail records (see Finding 1) .

RECOMMENDATIONS

We recommend that UA:

- a. Automate its process for estimating taxes due from employers who are delinquent in filing their quarterly tax reports and payments.
- b. Update its existing automated information systems to improve the effectiveness and efficiency of its accounting and other program operations.

AGENCY PRELIMINARY RESPONSE

UA agrees with the finding and informed us that a technology service request to automate the estimation of delinquent tax reports was submitted to the Bureau of Information Technology on April 11, 2001. The noted modification should be enacted when the Remote Initial Claims* Project automates the estimation of taxes due from delinquent employers filing quarterly tax reports.

Also, UA informed us that it is in the process of rewriting its automated systems for the Remote Initial Claims Project. This project will completely reengineer the tax, benefit, wage, and accounting systems to make them much more effective and efficient by using automation and new technologies. During the development phase, the Tax Re-Engineering team will review outstanding service requests to incorporate them into the new design.

* See glossary at end of report for definition.

CUSTOMER SATISFACTION

COMMENT

Background: UA has surveyed its customers to measure customer satisfaction for the last several years. In 1999, UA established a goal to improve customer satisfaction to 94% by December 31, 2001. In 2000, UA adopted a mission statement that included a goal to strive for complete customer satisfaction. UA continues to monitor customer satisfaction with regular surveys of various groups that it serves. UA also has customer comment cards available in its offices to enable customers to readily comment on customer service. UA encourages its employees to provide good customer service by informing employees about positive and negative comments about service. Also, UA uses the results of the surveys to determine if any changes are needed to improve customer service.

Audit Objective: To assess the adequacy of UA's monitoring of its progress towards achieving complete customer satisfaction.

Conclusion: We concluded that UA had adequate monitoring of customer satisfaction. UA established three-year strategic goals including a goal of improving customer satisfaction to 94.0% by December 31, 2001. Surveys in 2000 and 1998 of customer satisfaction of employers that pay unemployment taxes and of jobless workers collecting unemployment benefits had the following results:

	Customer Satisfaction	
	2000	1998
Employers paying unemployment taxes	71.7%	86.8%
Jobless workers collecting unemployment benefits	90.0%	91.0%

UA analyzed the results of these surveys as part of its process to make changes needed to increase customer satisfaction. UA informed us that there were three primary reasons for the decline in customer satisfaction by employers responding to the 2000 survey. The first reason was reduced staffing. Many positions were vacant, including an important manager's position. Other vacant positions were under review for reorganization and left open. Also, the Tax Office was not allowed to fill a significant number of positions. The second reason was communication problems. Customer service personnel were sometimes not informed of new areas of customer concerns

that were being referred to them, so they were not always prepared to resolve the customers' concerns. The third reason was structural changes in UA's organization. Because of the organizational changes, UA staff sometimes referred customers needing assistance to staff that they did not realize lacked the authority to resolve the problem.

Glossary of Acronyms and Terms

claimant	A jobless worker that files a claim for unemployment benefits.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
goals	The agency's intended outcomes or impacts for a program to accomplish its mission.
MESC	Michigan Employment Security Commission.
mission	The agency's main purpose or the reason that the agency was established.
objectives	Specific outputs that a program seeks to perform and/or inputs a program seeks to apply in its efforts to achieve its goals.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
Remote Initial Claims	A system under development that will allow claims for unemployment benefits to be filed by phone or over the Internet rather than in a UA field office. This system is scheduled to be implemented on April 1, 2002.
reportable condition	A matter coming to the auditor's attention that, in the auditor's judgment, should be communicated because it represents

either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

UA

Unemployment Agency.